On Thin Ice: The Iran Nuclear Deal at Three

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Principal Findings

What’s new? The Iran nuclear deal is entering its fourth year of implementation, with Iran remaining in full compliance with its obligations. Meanwhile, the Trump administration, which unilaterally withdrew the U.S. from the deal in May 2018, has reimposed punitive sanctions on Iran. These have started to bite.

Why does it matter? The U.S. appears to believe that economic and other pressure will compel Iran to renegotiate, suspend its ballistic missile program or reduce its regional footprint, or even trigger regime-shaking unrest. Iran’s patience to date could snap, leading it to violate the nuclear deal itself or retaliate against U.S. assets nearby.

What should be done? To prevent an escalation, Tehran should continue complying with the deal, exercise restraint and help calm regional conflicts. It should also reform its banking sector. Other remaining signatories should engage Iran diplomatically and economically. Candidates in the 2020 U.S. presidential election should say they would rejoin the deal if elected.
**Executive Summary**

That the Iran nuclear deal, known as the Joint Comprehensive Plan of Action (JCPOA), has so far survived the May 2018 U.S. withdrawal is remarkable, owing much to the other signatories’ efforts to keep it alive. But with Washington actively undermining the deal through reimposition and aggressive enforcement of sanctions, with increasing risks of spillover from growing regional tensions, and reports that some U.S. officials want a confrontation, the agreement remains highly vulnerable. Iran might well persist with its present approach of complying with the deal and waiting out the Trump administration, but it will require continued efforts by Europe in particular, as well as Russia and China, to provide it with diplomatic and economic incentives. Tehran could facilitate these efforts by enhancing its banking standards and demonstrating its ability to play a more constructive role in the region, starting with pressuring the Huthis in Yemen to fully implement the initial deal brokered by the UN special envoy. Democratic candidates in the 2020 U.S. presidential election should affirm their intent to rejoin the deal.

It is easy to lose sight of the fact that the JCPOA, entering its fourth year of implementation, is serving its primary objective. According to the International Atomic Energy Agency (IAEA), Iran’s nuclear program remains contained within the limits imposed by the deal. Yet the deal’s core bargain (i.e., sanctions relief in return for nuclear restrictions and monitoring) has unravelled, as the reimposition of U.S. sanctions has deprived Iran of most of the promised benefits. While unilateral, U.S. sanctions are proving effective: they have left Iran with rapidly dwindling oil revenues and contributed to skyrocketing inflation.

While Washington’s ultimate goals are not entirely clear, the U.S. administration appears determined to push Iran’s economy down to the ground, international investors and traders out of the country, and the Iranian people into the streets. For some officials, the objective is to bring Iran back to the negotiating table; for others, to pressure it to curb its regional actions and ballistic missile program; and for still others, to destabilise or even topple the regime.

The JCPOA’s fate now seems to depend on a three-way race against the clock: the U.S. is trying to bring maximum pressure to bear on Iran in the minimum amount of time in the hope that Iran’s economy crumbles; Iran is exercising patience in the hope that the Trump administration fails, becomes distracted or is ousted from power in 2020; and Europe has embarked on an earnest but largely symbolic scramble to prevent the deal’s derailment by offering Iran enough economic and diplomatic incentives for it to remain in the deal without deepening the trans-Atlantic rift.

Against the low probability of renegotiation, given Tehran’s reluctance to validate Trump’s pressure policy, or of regime change, and considering Iran’s extensive experience in surviving economic duress and suppressing dissent, Washington might succeed in strangling Iran’s economy without achieving any of its goals. Instead, it could lead Iran to evade the deal’s nuclear constraints or to use its proxies to target U.S. assets in the region. Both steps in turn could provoke a military confrontation. To add another element of uncertainty: political jockeying in both capitals is likely to increase in the run-up to Iran’s 2020 parliamentary and 2021 presidential elections.
(and a potential transition to a new supreme leader), and the U.S. presidential election in 2020.

Even assuming the deal survives until these potential turning points, reverting to the status quo ante might not be sustainable. If Trump wins re-election, it would be hard to imagine Iran weathering another four years of crippling sanctions. If a Democratic candidate were to prevail, he or she might well agree to resume U.S. compliance with the deal, but also face strong pressure to fortify the JCPOA, given that in 2024 the sun will set on key limits on Iran’s uranium enrichment capacity.

In other words, at some point in the future there is a high probability that a successor agreement building on the JCPOA will be required. While Iran does not wish to contemplate this scenario at present, the fact is that none of the parties to the JCPOA is fully satisfied with the deal – neither Iran, because even under the Obama administration sanctions relief was insufficient, nor the U.S. or Europe, because certain nuclear constraints will expire relatively quickly and the deal does not limit Tehran’s ballistic missile program and regional activities. The next two years could thus be well spent exploring options for a more sustainable successor arrangement that advances all sides’ interests.

Ultimately, the same calculus that brought Iran and world powers to compromise after thirteen years of standoff and two years of intensive negotiations, and which has led remaining JCPOA signatories to preserve it without the U.S., still holds: the alternatives to this agreement – a race between sanctions and centrifuges that could culminate in Iran obtaining the bomb or being bombed – would be much worse. They still can and should be avoided.

_Tehran/Washington/Brussels, 16 January 2019_
On Thin Ice: The Iran Nuclear Deal at Three

I. Introduction

In an era that now seems a distant memory, the Joint Comprehensive Plan of Action (JCPOA) received unanimous UN Security Council endorsement on 20 July 2015. It entered into force on 18 October 2015, and started being implemented on 16 January 2016 – after the International Atomic Energy Agency (IAEA) certified Iran’s fulfilment of its commitments – triggering sanctions relief. In the last two years’ status reports, Crisis Group noted that while Iran improved over time in meeting its nuclear commitments, sanctions relief failed to deliver on Iran’s (arguably inflated) expectations of an economic payoff.1

Donald Trump’s election in November 2016 made matters far worse. Trump, as candidate, had sworn to withdraw the U.S. from the accord.2 As president, he took a first stab at undermining the deal in October 2017, when he refused to certify it on the grounds that sanctions relief had been disproportionate to Iranian nuclear concessions.3 By January 2018, Trump indicated he had run out of patience with his national security team’s efforts – and Congress’s reluctance – to amend the deal. Thus, while renewing U.S. sanctions waivers on 12 January 2018, he declared that he would nix the deal if Congress and Europe failed to fix it by May 2018.4 After several rounds of intense negotiations between the UK, France and Germany (collectively known as the E3) and the Trump administration, a mutually acceptable compromise among Western powers seemed within reach, but Trump deemed the progress insufficient and pulled the U.S. out of the JCPOA on 8 May 2018, starting the clock on the U.S. sanctions snapback.5

The remaining JCPOA signatories have protested Washington’s decision and tried to keep Iran compliant with the deal by actively working to preserve some of its economic dividends.6 Though their efforts are politically commendable, their ability to cajole private-sector actors, in particular, has been extremely limited. As a result, unilateral U.S. sanctions have inflicted serious harm on the Iranian economy. At the same time, the Trump administration has outlined – at least – thirteen demands

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upon Iran entailing an overhaul of its nuclear, foreign and defence policies.\textsuperscript{7} It has also launched a diplomatic and information campaign against Iran, coordinated by a dedicated unit at the State Department.\textsuperscript{8} The combination of these measures has convinced the Iranian leadership that Washington’s real motive might be more than behaviour change.\textsuperscript{9}

As it enters its fourth year of implementation, the JCPOA is growing increasingly vulnerable. This report, which examines what will need to be done to both salvage the deal and avoid a regional escalation, is based on interviews conducted throughout the year with European, Iranian and U.S. officials and private-sector stakeholders, as well as IAEA officials. It analyses the third-year record of implementation and draws lessons from it. It suggests that – besides Iran remaining compliant with the deal and efforts by other remaining co-signatories to provide Tehran with economic and diplomatic incentives to do so – one way of sustaining the accord is to quietly explore ways to bolster it.

\textsuperscript{7} See “After the Deal: A New Iran Strategy”, State Department, 21 May 2018; and the Iranian foreign minister’s response: “Zarif’s response to Pompeo’s 12 demands”, Iran Daily, 20 June 2018. Faced with criticism that the U.S. had set no conditions for improvement of human rights in Iran, Pompeo subsequently added that demand to the list. Michael Pompeo, “Confronting Iran”, Foreign Affairs, November-December 2018. A Trump administration official said, “the twelve conditions are neither pre-conditions nor the outcome of negotiations, but an opening salvo”. Crisis Group interview, Washington, October 2018.

\textsuperscript{8} “Remarks on the Creation of the Iran Action Group”, State Department, 16 August 2018.

II. Implementation Record: A Mixed Bag

The bargain at the JCPOA’s core is delivering mixed results: the accord continues to verifiably restrict and rigorously monitor Iran’s nuclear program, but the U.S. exit and reimposition of its nuclear-related sanctions, supplemented by new ones, have largely deprived Iran of the deal’s promised economic dividends.

A. Nuclear Commitments

Since January 2016, the IAEA has verified Iran’s JCPOA compliance on thirteen separate occasions, and the UN secretary-general has attested six times that Iran is abiding by its JCPOA obligations.10 The U.S. withdrawal notwithstanding, Iran has even enhanced its cooperation with the IAEA – a clear attempt at depriving the U.S. of any pretext for shifting the blame to Iran.11 Tehran committed no technical infringements in the third implementation year and kept a comfortable distance from the JCPOA’s thresholds for stockpiles of sensitive material – ie, 130 metric tonnes for heavy water and 300kg for low-enriched uranium.12 Iran operated no more than 5,060 IR-1 centrifuges at Natanz and no more than 1,044 IR-1 centrifuges at Fordow.13

Progress lagged on the conversion of the heavy-water reactor in Arak into a proliferation-resistant one and the bunkered Fordow facility into a research and medical isotope production centre – but these delays, for which the U.S. withdrawal along with complex negotiations over technical designs and costs were largely responsible, do not constitute a violation of the agreement.14 Indeed, the U.S. sanctions snapback

11 Crisis Group interviews, European and IAEA officials, Brussels, December 2018. Interestingly, the Trump administration has not contested the fact that Iran has lived up to the letter of the agreement. “There’s nothing to suggest they’re not in compliance”, said a senior State Department official. Quoted in “Special Representative for Iran Brian Hook with Traveling Press”, U.S. State Department, 4 December 2018.
12 As of November 2018, Iran had 122.8 metric tonnes of heavy water (having shipped out 1.7 tonnes and using 1.5 metric tonnes for research activities since August) and 149.4kg of uranium enriched to 3.67 per cent.
13 Under IAEA monitoring, Iran moved 33 centrifuges from storage to replace damaged IR-1 centrifuges in Natanz and used three machines for research purposes in Fordow. GOV/2018/47, op. cit.
14 According to Iranian and EU officials, designs for the modified Arak reactor have been finalised, but negotiations between Iran and China for construction of the reactor’s vessel and fuel rods are ongoing. First phase of testing on IR-1 centrifuges in Fordow has been completed and the model machines for stable isotope production have been transferred to Russia for further testing. Crisis Group interviews, Brussels, May-December 2018. As a European official explained, “replacing the U.S. after its exit with the UK as the co-chair of the Arak project [along with China] resulted in the loss of institutional knowledge and caused delays”. Crisis Group telephone interview, Vienna, 19
compounded the problem. Having designated the Atomic Energy Organisation of Iran (AEOI) and 23 of its subsidiaries as sanctioned entities, the Trump administration granted waivers for the Arak and Fordow projects, as well as the Bushehr power plant, where Russia provides fuel for the existing light-water reactor, repatriates its spent fuel and is constructing two additional power reactor units.15 While, in the words of a Trump administration official, “these measures demonstrate that the U.S. does not stand in the way of a civilian nuclear program in Iran”, the details of these waivers remain ambiguous, creating doubt about their sustainability, and thus causing additional delays in these facilities’ completion.16

Nuclear cooperation, as outlined in JCPOA Annex III, is one of the accord’s key components, yet it is voluntary. In October, the IAEA held an international workshop on radioactive waste management in Iran.17 The European Union (EU), which has invested €20 million in enhancing the country’s nuclear safety practices, held its third high-level seminar on nuclear cooperation with Iran in November 2018, but tangible progress remains scant.18 The JCPOA’s procurement channel for Iran to gain access to dual-use material and equipment, managed by the Joint Commission’s procurement working group, also seems to have slowed down. While it received and processed the same number of applications as in 2017 (ie, eighteen) related to export of dual-use technology to Iran, it received only one (from Germany) after the U.S. reimposed its first round of sanctions in August 2018.19

By provisionally implementing the IAEA’s Additional Protocol to the Comprehensive Safeguards Agreement, as well as all the supplementary enhanced safeguards and transparency measures outlined in the JCPOA, Iran put its nuclear program under the most robust inspection regime currently in existence.20


15 “Constraining Iran’s Nuclear Program”, U.S. Department of State, 5 November 2018.
16 Crisis Group interview, Brussels, 18 December 2018. A senior European official said: “No one has seen these waivers. U.S. Treasury officials deliberately keep everyone in the dark about them so that they deter anyone from making a long-term investment in Iran’s nuclear program”. Crisis Group interview, Brussels, 18 December 2018. A State Department fact sheet about the waivers notes: “Permitting these specific activities to continue is an interim measure that preserves oversight of Iran’s civil nuclear program.... Each of the waivers we are granting is conditional on the cooperation of the various stakeholders”. See “Constraining Iran’s Nuclear Program”, op. cit.
17 “Int’l nuclear waste management workshop kicks off in Iran”, IRNA, 9 October 2018.
19 This proposal was German, as were the previous four submitted since June 2018. Since Implementation Day, the procurement channel received a total of 42 proposals, 28 of which were approved, four disapproved and nine withdrawn. One is currently under review. Crisis Group interviews, UN and Dutch officials, New York, 30 November 2018.
20 The Additional Protocol (INFCIRC/540) to the IAEA’s Comprehensive Safeguards Agreement expands the agency’s reach to all parts of a state’s nuclear fuel cycle and provides greater access rights. According to the IAEA’s director general, UN inspectors spend 3,000 calendar days per year on the ground in Iran (twice the number in 2013), has some 2,000 tamper-proof seals on nuclear material and equipment, and collects and analyses hundreds of thousands of images captured daily by sophisticated surveillance cameras in Iran. “Iran is implementing nuclear-related JCPOA commitments”, IAEA, 5 March 2018.
Nonetheless, Israeli Prime Minister Benjamin Netanyahu strove to prompt an inspection crisis, which could put Iran, if it were to deny UN inspectors access to “suspect” sites, in non-compliance. In April, Netanyahu revealed 55,000 pages of documents and another 55,000 files on 183 CDs that Israeli intelligence operatives removed from a clandestine archive in Tehran in early 2018. In September, he claimed the existence of another warehouse in Tehran containing “as much as 300 tons of nuclear-related equipment and material” in “15 shipping containers”. He also alleged that the facility had held 15kg of radioactive material that Iran had since dispersed around Tehran. He charged that the IAEA was not doing enough to follow up on information on Iran’s past nuclear weapons work and called on the agency’s director-general to “do the right thing. Go inspect this atomic warehouse. Immediately. Before the Iranians finish clearing it out.” The IAEA, however, did not succumb to pressures to politicise its verification work in Iran. Nor did other countries with whom Israel shared the intelligence alter their approach.

A concern during this period was that, in response to U.S. violations, Iran could tinker with the deal around the edges. While it did not do so, Supreme Leader Ali Khamenei ordered the AEOI to “quickly make preparations to reach to 190,000 SWU [“separative work units”, which are a measure of uranium enrichment capacity]”, in case European efforts to mitigate the impact of U.S. sanctions failed. In response, the AEOI reopened a plant for the production of uranium hexafluoride (or UF₆, which is the feedstock for centrifuges); refurbished the electrical infrastructure at Natanz enrichment site; and built a factory that purportedly can produce rotors for up to 60 advanced centrifuges per day. More recently, Iran announced preliminary

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22 A U.S. intelligence official called Netanyahu’s comments “somewhat misleading. First, we have known about this facility for some time, and it’s full of file cabinets and paper … and second, so far as anyone knows, there is nothing in it that would allow Iran to break out of the JCPOA any faster than it otherwise could”. “Netanyahu, in U.N. speech, claims secret Iranian nuclear site”, Reuters, 27 September 2018.
23 “Prime Minister Benjamin Netanyahu’s 2018 UN General Assembly speech”, *Haaretz*, 27 September 2018. Critics of the deal and lobby groups joined the effort to put more pressure on the IAEA. For example, see “IAEA must inspect secret Iranian nuclear sites”, memorandum, American Israel Public Affairs Committee, 3 October 2018; David Albright, Sarah Burkhard, Olli Heinonen and Frank Pabian, “What the Atomic Archive Reveals about Iran’s Past Nuclear Weapons Related High Explosive Work at the Parchin High Explosive Test Site”, Institute for Science and International Security, 23 October 2018.
24 “IAEA says it won’t take intelligence at face value after Netanyahu’s Iran speech”, Reuters, 2 October 2018. The agency says it has had access to wherever it wanted to inspect and benefits from a unique feature in the JCPOA, requiring Iran to grant access to any suspect sites within 24 days or face consequences. Crisis Group interviews, IAEA officials, Brussels, December 2018.
25 European officials noted that the archived material added nuance to what they and the IAEA already knew about Iranian efforts to obtain nuclear weapons prior to 2003, validating the need for the JCPOA. Crisis Group interviews, Brussels, December 2018.
26 “The Iranian nation and its government will not tolerate to be both subject to sanctions and have its nuclear program restricted and imprisoned”, he added. Najmeh Bozorgmehr and Michael Peel, “Khamenei turns up pressure on Iran nuclear deal”, *Financial Times*, 4 June 2018.
steps to design a more efficient 20 per cent fuel assembly for the Tehran research reactor.\(^{28}\) None of these steps violates the JCPOA, but, in a clear attempt by Iran to increase the pressure on the remaining parties to the deal, signalled what its unravelling could entail.

B. **Sanctions Relief Commitments**

Following the lifting of nuclear-related international sanctions in January 2016, the contours of an Iranian economic recovery took shape. Iran’s GDP growth rate was at 1.6 per cent in the year before the deal, and then swelled to 12.5 per cent in the year after it took effect, continuing to grow by 3.7 per cent in 2017-2018. Inflation fell to single digits.\(^{29}\) Yet despite the inking of several marquee deals with major foreign firms, normalising banking ties remained a challenge. Growth had already stalled by the summer of 2017 as uncertainties around the JCPOA’s fate drove away much needed foreign investment and left the market in limbo.\(^ {30}\)

The U.S. decision to withdraw from the JCPOA made those fears real. Scores of international companies announced that they would end or suspend their operations in Iran even before U.S. sanctions formally came into effect.\(^ {31}\) These came in two major tranches: an initial set of non-oil sanctions on 7 August, and a second more significant batch on 5 November against over 700 persons and entities, including around 300 new targets.\(^ {32}\) As per previous sanctions (2010-2013), these latter sanctions targeted Iran’s lifeline: its oil exports. Officially aimed at reducing these

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\(^{28}\) “Iran taking first steps to design 20% modern nuclear fuel: nuclear chief”, Press TV, 13 January 2019.

\(^{29}\) “Iran Economic Monitor: Weathering Economic Challenges”, World Bank, Fall 2018.

\(^{30}\) A Crisis Group survey of international companies revealed that businesses remained cautious toward the Iranian market: nearly four in five admitted to having postponed plans to invest in the country, and 57 per cent cited existing or potential U.S. sanctions as the primary reason for their reluctance. See Crisis Group Report, *The Iran Nuclear Deal at Two*, op. cit.

\(^{31}\) U.S. officials estimate that by early November “more than 100 major companies from around the world have withdrawn from Iran or canceled their planned investments. And this is tens of billions of dollars in lost investment”. See “Telephonic Press Briefing with Brian Hook, U.S. Special Representative for Iran”, State Department, 5 November 2018. A European entrepreneur captured a common sentiment in international boardrooms: “There’s a primacy of a political system. If that primacy says ‘this is what we’re going to do’, then that is exactly what we’re going to do”. Quoted in “Siemens CEO: We can’t do new deals with Iran”, CNN, 14 May 2018.

\(^{32}\) The August sanctions covered “the purchase or acquisition of U.S. bank notes by the Government of Iran; Iran’s trade in gold and other precious metals; graphite, aluminum, steel, coal and software used in industrial processes; transactions relating to the Iranian rial; activities relating to Iran’s issuance of sovereign debt; and Iran’s automotive sector”. The November sanctions targeted Iran’s energy, shipping, insurance and financial sectors, and revoked exemptions in U.S. primary sanctions, including those that allowed certain U.S. subsidiaries to conduct business with Iran. “President Donald J. Trump is Reimposing Sanctions Lifted Under the Horrible Iran Deal”, White House, 6 August 2018; “Statement by the President Regarding the Re-imposition of Nuclear-related Sanctions on Iran”, White House, 2 November 2018; and “U.S. Government Fully Reimposes Sanctions on the Iranian Regime as Part of Unprecedented U.S. Economic Pressure Campaign”, Treasury Department, 5 November 2018. The November designations included “over 300 ... new targets”, putting the total number of designations under the Trump administration at over 900. “Press Availability with Secretary of Treasury Steven T. Mnuchin”, State Department, 5 November 2018.
exports to nil, the Trump administration’s maximalism helped it remove as much Iranian oil from the market (approximately one million barrels per day) as its predecessor did with international support before the JCPOA. More damaging to the Iranian economy than the reduced volume of oil exports is the requirement under U.S. sanctions that their proceeds, which constitute 35 per cent of government revenue as per the annual budget, remain locked in escrow accounts that can only be used for imports from those countries.

Perhaps most indicative of Iran’s post-sanctions economic troubles is its currency crisis, which saw the rial lose nearly 70 per cent of its value from March to September 2018. In fact, U.S. sanctions pushed at an open door, exposing inherent weaknesses in Iran’s economy and policymakers’ missteps in addressing them. Even before sanctions snapped back, Iran’s banking sector, burdened by a high percentage of nonperforming loans, was reaching breaking point. Dozens of unlicensed credit unions, which had mushroomed over the past few years, became insolvent in 2017, sending angry depositors into the streets. To calm the situation, the government bailed out these institutions and repaid the depositors, adding to the already ballooning money supply in parallel to slashing interest rates.

To protect their assets or secure a profit, many Iranians started converting their rial holdings into foreign currencies and gold. The increase in demand for hard currencies coincided with challenges Iran faced in repatriating its oil revenues, as in early 2018 financial regulators in Dubai and Turkey severed banking channels to

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33 Crisis Group interviews, European and Asian energy executives, Paris, 14-15 November 2018. Iran’s exports declined from 2.7 million barrels per day (mb/d) in June to 1.9 mb/d in September. “Iran Has Produced and Exported Less Crude Oil since Sanctions Announcement”, U.S. Energy Information Administration, 23 October 2018. Precise figures for Iran’s total post-sanctions oil exports (ie, November and December) are nebulous, as is the exact volume of import reductions by the eight countries that were granted waivers.

34 Section 504 of Iran Threat Reduction and Syria Human Rights Act of 2012 makes repatriating Iran’s oil export earnings a sanctionable act, thus forcing Tehran to barter with its remaining oil clients. See H.R. 1905 – Public Law: 112-158, 10 August 2012. Iran’s fiscal reliance on oil revenues has decreased from 50.5 per cent in the 2012 budget to 35 per cent in the 2019 proposed budget. Nearly two thirds of oil revenues will be earmarked for the government budget, with the remainder split between the National Development Fund and National Iranian Oil Company. Donya-ye Eqtasad, 27 December 2018. As a U.S. official explained: “Any time Iran sells oil, that money goes into an escrow account in the importing nation’s bank … the U.S. will be monitoring these escrow accounts very closely”. “Briefing with Special Representative for Iran Brian Hook”, State Department, 2 November 2018.

35 The rial’s value fell from around 47,000 to the U.S. dollar at the start of the fiscal year (March 2018) to as low as 190,000 in September. Thomas Erdbrink, “Steep slide in currency threatens Iran’s economy”, The New York Times, 11 April 2018.

36 According to some estimates, nearly half of the loans granted by Iranian banks (amounting to around $30 billion) are considered non-performing. “New report reveals banks’ NPL ratio gap”, Financial Tribune, 23 May 2018.

37 According to a Central Bank of Iran official, there were nearly 6,000 unauthorised credit agencies, holding deposits of nearly three million citizens. Crisis Group interview, Tehran, May 2018.

38 The money supply has increased 24 per cent annually for the past four years, surpassing the GDP during previous Iranian fiscal year (ending in March 2018). “Summary of the Assets and Liabilities of the Banking System”, Central Bank of Iran, 17 December 2018.
Iran. Sensing the shortage of hard currency, the market panicked and the rial, whose value the government had kept artificially high for six years, started to slide against the U.S. dollar. The government’s response was disastrous, starting with its failure to take precautionary measures. It then exacerbated the crisis by reducing the official exchange rate by about 15 per cent and unifying it with the open-market rate; restricting movement of capital out of Iran; declaring possession of foreign currency in excess of C10,000 illegal; blaming the crisis on speculators, its internal rivals and foreign foes; and shutting down foreign exchange bureaus, while injecting dollars into the market. These steps empowered the black market, accelerated capital flight and permitted rent-seekers to benefit from arbitrage.

Then in August, in a major turnabout, the government decided to stop dictating the exchange rate, allowing the open market to do so. In parallel, however, and to combat the ensuing inflation, it maintained the exchange rate of 42,000 rials to the U.S. dollar for importing $14 billion worth of essential staples. With more revised fiscal policies, the rial regained some ground and was trading at around 116,000 to the U.S. dollar on 14 January 2019 in the open market. Nonetheless, devaluation caused prices of imported consumer goods and domestically produced goods using imported intermediate components to soar. The year-on-year inflation rate in December 2018 reached 34.9 per cent. In August, Iranian officials projected that the country would lose nearly a million jobs by March 2019 as a result of sanctions.


40 The most obvious of these was the decision to keep the exchange rate constant from 2012 to 2018, during which time Iran’s prices nearly doubled relative to those of its trading partners. See Djavad Salehi-Isfahani, “Yes, Iran’s economy is suffering – but it’s not all about the U.S.”, Foreign Affairs, 25 September 2018; Rohollah Faghihi, “The app destroying Iran’s currency”, Foreign Policy, 22 November 2018.

41 A prominent Iranian economist said, “when you overvalue the rial for years, don’t adjust it to inflation, and ignore the writing on the wall that the market is starting to panic with the looming specter of sanctions, you only have yourself to blame”. Crisis Group interview, Washington, December 2018.

42 “Iran unifies official and open market exchange rates as rial hit new low”, Reuters, 9 April 2018. “خروج 30 مليار دولار داز در چند ماه و نتایج منفی ارز گران” [“$30 billion fled the country in a few months and negative ramifications of strong U.S. dollar”], Boursepress.ir, 27 March 2018. Some speculate that the government purposely did not adjust the foreign exchange rate in time to allow vested interests to convert and extract their capital. Crisis Group interviews, Iranian economists and bankers, Tehran, November 2018. Since then, senior Central Bank officials have been arrested or barred from leaving the country. “Iran forex chief arrested in tense build-up to sanctions return”, Radio Farda, 5 August 2018.

43 “Iran eases currency rules, hoping to buoy rial ahead of sanctions”, Reuters, 5 August 2018. The government also created Iran’s Portal for Unifying Currency Exchanges, widely known as NIMA, designed as a platform for businesses to buy foreign currency from exporters such as petrochemical companies. Bijan Khajehpour, “Iran pushes for transparency to deal with currency instability”, Al-Monitor, 1 May 2018.

44 Conversion rates taken from Bonbast.com.

45 “Inflation rate in Iran continues to rise in autumn”, Mehr News, 23 December 2018. According to Iran’s Statistical Centre, inflation was driven by price rises in food (59.9 per cent), tobacco (150.8 per cent), and clothing (48.5 per cent), among other goods and services. Djavad Salehi-Isfahani,
While the currency crisis has had some upsides for the government – eg, allowing it to pay most of its debt to the banking sector and stem capital flight – it took a toll on the Rouhani administration, which many Iranians perceived as impotent at best and incompetent at worst. The president was forced to replace the Central Bank’s governor in July; in October he made four new appointments to key cabinet positions after parliament impeached the labour and economy ministers; in November he accepted his key pro-market economic adviser’s (Masoud Nili) resignation; and in January 2019 he had to let go of his health minister, who had protested budget cuts. And, in a rare move, parliament summoned the president for questioning.

In parallel, the Rouhani administration has strived to blunt the impact of U.S. sanctions. It has emphasised expanding trade relations with Iran’s neighbours. An oil bourse, the Iran Energy Exchange, has begun oil sales from the National Iranian Oil Company to private buyers, notwithstanding the oil minister’s concerns that it may lead to massive embezzlement, as during previous sanctions regimes. There are indications that Iran is reviving a practice of blurring its crude-oil shipments by disabling oil tankers’ location transponders. Tehran is also mulling using cryptocurrencies to evade U.S. sanctions.

“Has Iran’s inflation peaked?”, Tyranny of Numbers, 28 November 2018; Saeid Jafari, “Iran consumer prices remain stubbornly high despite rial recovery”, Al-Monitor, 27 December 2018.

“Iranian jobs go as U.S. sanctions start to bite”, Reuters, 19 November 2018. Iran’s automobile industry, the second biggest employer after the oil industry, reported a 72 per cent reduction in car production in December 2018 compared to the previous year. ISNA, 31 December 2018.

The most popular Iranian social media hashtag at the height of the currency crisis was “where is Rouhani”, who eventually emerged hiking in the mountains near Tehran. “بﺮﺩﺍﺷﺘﻦ ﻓﮑﺮ ﺑﻪ! ﺭﻭﺣﺎﻧﯽ ﺁﻗﺎی ﺭﻭﻫﺎﻧی! Think of removing the mountain of troubles”, Tabnak, 25 June 2018.

A prominent Iranian economist noted, “Rouhani’s mistake was to go into the storm of sanctions with the same cabinet he employed in his first term to open the economy and absorb foreign capital”. Crisis Group interview, Washington, December 2018. “Iran names new economy minister in reshuffle as U.S. sanctions bite”, Reuters, 21 October 2018; “Rouhani accepts Hashemi’s resignation as health minister”, Mehr News, 3 January 2019.

It was only the second time (after the former president, Mahmoud Ahmadinejad) that the parliament had summoned a sitting president. Tamer El-Ghobashy, “Iran’s parliament delivers rare rebuke to embattled President Rouhani”, Washington Post, 28 August 2018. The supreme leader welcomed the questioning but did not allow it to end in impeachment. As one of Rouhani’s advisors noted, “this is a win-win for Ayatollah Khamenei: he puts the current situation’s blame around Rouhani’s neck, while keeping him in place to fix the mess”. Crisis Group interview, Tehran, September 2018.

Data from the Trade Promotion Organisation of Iran indicates that between March and November 2018, Iran’s non-oil exports to Iraq surged 67 per cent year-on-year. There were also 26 per cent increases to the UAE and Afghanistan, while exports to Pakistan and Oman saw growth of 63 and 57 per cent, respectively. Iran’s overall non-oil regional trade over this period was up 11.6 per cent. “Iran’s non-oil trade with neighbors exceeds $24 billion in 8 months”, Eghtesad, 12 December 2018.


“Untraceable cryptocurrency can help us bypass sanctions”, CNN, 30 October 2018.
In August, Supreme Leader Khamenei authorised the establishment of special courts to try economic corruption cases.\(^{54}\) If past is prologue, however, efforts to tackle corruption will face an uphill battle at a time when Iran increasingly relies on smuggling and black-market trade to circumvent sanctions.\(^{55}\) The black market’s allure will also undermine the government’s push to get other power centres to approve a hotly debated series of bills intended to remedy deficiencies in Iran’s anti-money laundering and terrorism financing policies along the lines prescribed by the Financial Action Task Force (FATF) – a key expectation of Europeans trying to help Iran preserve some of its banking channels to the outside world.\(^{56}\)

As with previous rounds, the new U.S. sanctions inevitably will create winners and losers – and have unintended consequences.\(^{57}\) Persons and groups with greatest access to state privileges, particularly the Islamic Revolutionary Guard Corps (IRGC), which controls borders, are best positioned to survive and even thrive in the new environment.\(^{58}\) In contrast, the middle class and the poor bear the brunt of the economic duress.\(^{59}\) Reports from Tehran suggest the emergence of a black market in medications and medical supplies amid shortages and rising prices.\(^{60}\) The U.S. blacklisting of Parsian Bank, one of Iran’s most reputable private-sector institutions, which U.S. Treasury officials allege has links – with seven to eight degrees of separation – to Iran’s paramilitary Basij force, has had a chilling effect.\(^{61}\) Banking restrictions have also reportedly impeded food imports, while Iranian officials claim that the

\(^{54}\) “Punishment of convicts of economic corruption must be carried out urgently and justly”, Khamenei.ir, 11 August 2018. Iran executed at least three people and arrested dozens on corruption charges in November and December 2018. “Commander: Iran police tough on economic corruption”, Tasnim, 19 December 2018.

\(^{55}\) Iran ranks 130th out of 180 countries assessed by Transparency International.

\(^{56}\) The FATF sets anti-money laundering and counter-terrorism financing standards for financial institutions worldwide. In its October 2018 plenary, the FATF extended the suspension of countermeasures against Iran, setting February 2019 as the next deadline for addressing nine areas of continued concern. See “Public Statement”, Financial Action Task Force, 19 October 2018. One of the four measures, which amends Iran’s counter-terrorism financing laws, was approved in August. Amendments to bills on joining the Convention Against Transnational Organised Crime and the Convention for the Suppression of the Financing of Terrorism are under review. “Iran approves anti-money laundering bill to ease foreign trade”, Reuters, 5 January 2019.

\(^{57}\) For more background on the previous round of sanctions, see Crisis Group Middle East Report No.138, Spider Web: The Making and Unmaking of Iran Sanctions, 25 February 2013.

\(^{58}\) Esfandyar Batmanghelidj, “Tougher U.S. sanctions will enrich Iran’s Revolutionary Guards”, Foreign Policy, 4 October 2018.

\(^{59}\) Monavar Khalaji, “Iran’s poor to bear brunt of Trump’s oil sanctions”, Financial Times, 30 October 2018; Thomas Erdbrink, “Iran’s economic crisis drags down the middle class almost overnight”, The New York Times, 26 December 2018. In December, Iran’s Statistical Centre found food and beverages prices were nearly 52 per cent higher than at the same point in 2017.


aviation sector, whose hopes of a post-JCPOA fleet overhaul were dashed, is encountering difficulties refuelling in Europe.\textsuperscript{62}

With the World Bank forecasting a marked rise in inflation and a 1.6 per cent economic contraction in 2018-2019 (and a further 3.7 per cent shrinkage in 2019-2020), in addition to skyrocketing unemployment, Iran’s short- to medium-term economic picture is increasingly bleak.\textsuperscript{63}

That said, sources of resilience exist within the Iranian economy. The country’s foreign debt to GDP ratio is among the lowest in the world.\textsuperscript{64} It has a cushion of hard currency reserves, estimated at more than $100 billion.\textsuperscript{65} Non-oil exports are on the rise, providing Iran with a positive trade balance, and Tehran hopes that the remaining JCPOA signatories and other friendly nations will throw it an additional lifeline.\textsuperscript{66} Iran may be under severe sanctions, but the U.S. “maximum pressure” campaign is not air-tight, as market realities compelled Washington to grant eight waivers to key consumers of Iranian energy.\textsuperscript{67} Washington allowed two more economic carve-outs: a temporary allowance for Iraq’s import of Iranian electricity and an exclusion for Iran’s Chabahar port.\textsuperscript{68} The former was an acknowledgment of Iraq’s ongoing reliance on Iranian natural gas supplies, while the latter was a priority for India as well as Afghanistan.\textsuperscript{69}

\textsuperscript{62} Esfandyar Batmanghelidj, “Delays hit Iran’s imports of soybeans, maize as ships remain anchored offshore”, \textit{Bourse and Bazaar}, 10 December 2018. “Global traders halt new Iran good deals as U.S. sanctions bite – sources”, Reuters, 21 December 2018. “Europeans refusing fuel to Iranian aircraft: official”, Press TV, 18 December 2018. Over the past two decades, Iran has suffered from aviation-related accident and fatality rates at ten and 5.5 times the global averages, respectively. See Esfandyar Batmanghelidj, “For Iranian passengers, old planes and few parts make air travel 5.5 times more deadly”, \textit{Bourse and Bazaar}, 5 December 2018. Reacting to difficulties in conducting humanitarian trade with Iran, a U.S official said: “That’s Iran’s problem; it is not our problem”. Quoted in “Briefing with Special Representative for Iran Brian Hook”, State Department, 2 November 2018.

\textsuperscript{63} “Iran Economic Monitor World Bank”, op. cit. In January 2019, the official youth unemployment rate reached 27 per cent and over 40 per cent among university graduates. Ahmad Alavi, “Iran’s official figures indicate alarming unemployment rate later this year”, Radio Farda, 9 January 2019.

\textsuperscript{64} International Monetary Fund, “World Economic Outlook Dataset”, October 2018.

\textsuperscript{65} The CIA estimated Iran’s foreign currency reserves at the end of 2017 at $132 billion.

\textsuperscript{66} Data for March-December 2018 indicated an increase of more than 5 per cent year-on-year, with nearly $740 million in surplus. “Iran’s non-oil exports hit over $33 billion”, Mehr News, 30 December 2018.

\textsuperscript{67} “Briefing with an Iran Diplomacy Update”, State Department, 2 July 2018. The waiver recipients were China, India, South Korea, Japan, Taiwan, Turkey, Italy and Greece. “I could get the Iran oil down to zero immediately”, asserted President Trump, “but it would cause a shock to the market. I don’t want to lift oil prices”. “Remarks by President Trump Before Air Force One Departure”, White House, 5 November 2018.

\textsuperscript{68} The U.S. in December extended the initial 45-day Iraq waiver by three months. “Iraq receives 90-day extension to Iran sanctions waiver”, Associated Press, 21 December 2018. Iraqi energy officials estimate a minimum two-year timeframe before Iraq can do without Iranian gas imports. “Iraq needs two years to wean itself of Iranian gas”, Reuters, 6 December 2018.

\textsuperscript{69} As an Indian official put it, “New Delhi and Washington could find a mutually beneficial compromise. We reduce our oil imports from Iran and in return the U.S. will exempt Chabahar, which is key for our trade with Afghanistan”.

The full impact of sanctions largely will depend on how far China and India, Iran’s largest oil customers, will go in accommodating U.S. demands to significantly reduce their imports from Iran by April 2019 when existing waivers expire; on Switzerland’s ability to establish a banking channel aimed at supporting humanitarian trade (ie, food, medicine and medical equipment) with Iran;\textsuperscript{70} and on how successful Europe will be in facilitating trade with Iran though its Special Purpose Vehicle (SPV). The mechanism is designed to bypass U.S. restrictions through an accounting firm, backed by the E3’s central banks, that would establish a barter system using credits from Iranian exports to Europe to pay for European exports to Iran without requiring monetary transfers.\textsuperscript{71} That said, even though these factors can make a difference, none is likely to deliver genuine economic relief. Their significance, in other words, will be as much (if not more) political than financial.

\textsuperscript{70} Switzerland has been working on a banking channel for humanitarian goods, such as medicine and medical devices, expecting to launch it in early 2019. A Swiss diplomat said. “Given the importance of the Swiss pharmaceutical sector and medical devices as well as international commodity traders in Switzerland, I would expect that substantial volumes could be cleared through this channel”. Crisis Group interview, December 2018. Pharmaceuticals are a key sector in Swiss exports to Iran but have fallen in year-on-year figures that also show a drop in overall European pharmaceutical sales to Iran. See Esfandyar Batmanghelidj, “European pharmaceutical exports to Iran fall sharply”, \textit{Bourse and Bazaar}, 6 December 2018.

III. A Race Against Time

The JCPOA’s fate now seems to depend on a three-way race against time: the U.S. hopes to impose maximum pressure on Iran as quickly as possible in the hope that Iran’s economy crumbles; Iran is exercising patience in the hope that the Trump administration fails, becomes distracted or is voted out of office in 2020; and Europe is scrambling to put more time on Tehran’s clock while avoiding a deepening of the trans-Atlantic rift.

A. Washington: Maximum Pressure

The Trump administration has been clear on two aspects of its Middle East policy: Iran is the source of the region’s ills and sanctions are the chief tool for countering it. Not all officials agree on the ultimate objective, though all agree on the means that ought to be used and that an Iran under economic pressure is better than one that is not.\(^72\) The administration also is seeking to mobilise its allies against Iran’s ballistic missile tests and a wide range of other purported Iranian misdeeds, ranging from alleged non-compliance with the Chemical Weapons Convention to the treatment of protesters and endemic top-down corruption.\(^73\)

By reinstating sanctions while Iran remains within the restraints of the JCPOA, the U.S. can – in the words of a senior administration official – “have our cake and eat it too”: violate the agreement while Iran abides by it.\(^74\) Beyond that, some officials are satisfied at the thought that this gambit could deprive Tehran of some resources it uses to project power in the region.\(^75\) Several administration officials, including Trump himself, claim that they already are seeing tangible results, such as diminished Iranian deployment of and financial support for militant groups.\(^76\) It is hard to square these contentions, however, with U.S. accusations of heightened activity by

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\(^72\) Mike Giglio, “Trump’s new Iran strategy, inspired by the Cold War, calls for maximum pressure”, Buzzfeed, 25 September 2018.

\(^73\) “Statement by Ambassador Kenneth Ward to Organization for Prohibition of Chemical Weapons”, State Department, 21 November 2018; Dan Boylan, “State Department names and shames Iran on global anti-corruption day”, Washington Times, 10 December 2018. The State Department published a report (in seven languages) highlighting Iran’s “malign behavior” over the past forty years. Interestingly, the report, which covers subjects ranging from supporting terrorism to ballistic missiles, has no section on Iran’s nuclear program. See “Outlaw Regime: A Chronicle of Iran’s Destructive Activities”, State Department, 25 September 2018.

\(^74\) Crisis Group interview, New York, September 2018.

\(^75\) Crisis Group interviews, U.S. diplomats and Congressional officials, Washington, May-December 2018. A State Department official said, “Iran is overextended in the region: it’s paying the salaries of a total of 160,000 militia fighters region-wide. This is not sustainable for them under economic duress”. Crisis Group interview, Washington, October 2018.

\(^76\) Crisis Group interview, Washington, December 2018. Echoing the same view, Prime Minister Netanyahu claimed that U.S. sanctions have reduced the amount of money that Iran spends in Syria. “PM Netanyahu Meets with Foreign Ambassadors in the North, Near Where IDF Units Are Working to Expose and Neutralize the Tunnels”, Prime Minister’s Office of Israel, 6 December 2018. President Trump said, “Iran is pulling people out of Syria. ... They’re pulling people out of Yemen”. White House, 3 January 2019.
pro-Iranian Shiite groups in Iraq or continued claims of Iranian destabilising behaviour in Yemen.77

More hawkish members of the administration go farther in believing that economic distress could prompt domestic unrest – at a minimum compelling the Iranian leadership to focus far more on internal than on external issues.78 In what they consider the optimal scenario (despite repeated assertions that regime change is not U.S. policy), sanctions might destabilise the regime and trigger its collapse.79 National security advisor John Bolton reportedly hopes that Tehran’s reaction to increased pressure – directly or through one of its proxies – could provide the U.S. with the opportunity to conduct military operations against Iran.80 When in September the U.S. accused Iran of encouraging Shiite militias to target U.S. facilities in Basra and Baghdad, some officials allegedly argued that an appropriate response would be to target Iran itself; Bolton is said to have asked the Pentagon for plans for a military strike in response. Then Secretary of Defense Jim Mattis is said to have opposed any such endeavour.81 Secretary of State Mike Pompeo’s warning that the U.S. would not stand idly by if Iran were to go ahead with plans for launching satellites sounded equally ominous, possibly presaging some form of retaliation should Iran proceed.82

77 The Trump administration accused Iran of targeting U.S. diplomatic facilities in Baghdad and Basra through its allied Shiite paramilitary groups. Edward Wong, “Blaming Iran, U.S. evacuates consulate in southern Iraq”, The New York Times, 28 September 2018. In November a U.S. official said, “In the time since Ambassador [Nikki] Haley’s remarks [in December 2017], Iran’s support of the Huthi militants has deepened. Its backing of terrorist activities across the world has increased, and its efforts to undermine regional stability have expanded”. See “Iranian regime’s transfer of arms to proxy groups and ongoing missile development”, State Department, 29 November 2018.
78 Pompeo said, “the [Iranian] leadership has to make a decision that they want their people to eat … use their wealth to import medicine, and not use their wealth to fund [IRGC’s Quds Force Commander] Qasem Soleimani’s travels around the Middle East with – causing death and destruction”. Quoted in “Interview with Hadi Nili of BBC Persian”, State Department, 7 November 2018. “US official links economic protests in Iran to sanctions”, Associated Press, 12 July 2018.
79 As a Trump administration official put it, “regime change is not a strategy, but a hope”. Crisis Group interview, senior U.S. official, Washington, January 2019.
82 The technology used for satellite launch vehicles could theoretically be used in intercontinental ballistic missiles capable of reaching the U.S. mainland. “Warning to the Iranian Regime on Space Launches That Defy UNSCR 2231”, State Department, 3 January 2018. Michael Elleman, “How can
Trump himself, alongside several other officials, still appears interested in and intent on negotiating a new deal with Iran, believing it is only a question of time before pressure drives Tehran back to the bargaining table; indeed – to the apparent consternation of his more hard-line advisers – he has set no precondition for commencing negotiations.\textsuperscript{83} Some officials seem confident that talks between Tehran and Washington will occur before Trump’s first term ends.\textsuperscript{84} There are even reports that U.S. officials have reached out to Iranian officials to discuss the fate of U.S. prisoners in Iran and the future of Afghanistan, although to date Iran reportedly has rebuffed the outreach.\textsuperscript{85}

So far, there is little evidence that the administration is meeting any of its possible goals. A preliminary internal assessment by the administration described to Crisis Group purportedly concludes that the U.S. approach has yet to curb Iran’s behaviour or entice Tehran back to the negotiating table.\textsuperscript{86} Iran has accelerated the pace of its ballistic missile testing, and, according to U.S. officials, continues to transfer missile parts to Huthi rebels in Yemen and to Hizbollah in Lebanon and Syria.\textsuperscript{87} More broadly, there is little historical evidence of any correlation between Iran’s economic performance and regional policies.\textsuperscript{88}

Likewise, though many European capitals share Washington’s concerns about Iran’s ballistic missile tests and regional activities, the Trump administration’s brazen campaigning, including stark warnings to European firms not to evade U.S. sanctions, is causing unease in Western capitals. The European Union’s foreign policy chief, Federica Mogherini, has described the sanctions as a “false economy” and “vacuum diplomacy”.\textsuperscript{89} The European Commission’s vice president for trade, Valdis Dombrovskis, has similarly criticised the U.S. sanctions: “We don’t think that the sanctions are a strong argument.”\textsuperscript{90}

In December, Secretary Pompeo said: “We have hard evidence that Iran is providing missiles, training and support to the Houthis, and the Iranian-Houthi missile force is fully engaged. This poses a threat to innocent civilians – including Americans – living in Riyadh, Abu Dhabi, Dubai, as well as people of all nationalities who travel on civilian aircraft in that region”. See “Remarks at the United Nations Security Council Meeting on Iran”, State Department, 12 December 2018.

83 “Trump says he’d meet with Iran without preconditions ‘whenever they want’”, CNN, 31 July 2018. “U.S. made 11 attempts to negotiate with Iran in last two years: Iran president”, Reuters, 4 December 2018. Trump contended: “Iran is in trouble. And you know what? I’d love to negotiate with Iran. They’re not ready yet, I don’t think. But they will be”. White House, 3 January 2019.
87 There were 23 ballistic missile tests and strikes in 2018, compared to twelve in 2017, eleven in 2016 and six in 2015. “Final report of the panel of experts on Yemen”, S/2018/69, UN Security Council, 26 January 2018. Iran deems missile development a sovereign right and legitimate form of defence. UN Security Council Resolution 2231, which endorsed the JCPOA, in non-binding language “calls upon” Iran not to undertake until 2023 any activity related to ballistic missiles “designed to be capable of delivering nuclear weapons”; the resolution also lacks an internationally-agreed definition of nuclear-capable missiles, inviting diverging views on the Iranian program. See paragraph 3 of Security Council Resolution 2231’s Annex B. According to the Missile Technology Control Regime, missiles capable of carrying a 500kg payload across a minimum range of 300 kilometres could carry weapons of mass destruction. In December, Secretary Pompeo said: “We have hard evidence that Iran is providing missiles, training and support to the Houthis, and the Iranian-Houthi missile force is fully engaged. This poses a threat to innocent civilians – including Americans – living in Riyadh, Abu Dhabi, Dubai, as well as people of all nationalities who travel on civilian aircraft in that region”. See “Remarks at the United Nations Security Council Meeting on Iran”, State Department, 12 December 2018.
88 An assessment of the past four decades shows that Iran has engaged in activities it deems central to its national security however severe its economic situation has been. See Crisis Group Middle East Briefing N°64, The Illogic of the U.S. Sanctions Snapback on Iran, 2 November 2018.
sanctions, has stirred resentment in Europe and thus discouraged the kind of united front sought by the U.S.89 As further discussed below, prospects for achieving the other purported U.S. goal (new negotiations on a broader deal) appear dim, given Iran’s fear that agreeing to talks would only validate Trump’s approach and its insistence that the U.S. re-enter into compliance with the JCPOA before the two countries discuss anything more.90 In the same vein, the more Washington threatens Tehran, the likelier Iran is to double down on policies it deems key to its national security: its ballistic missile program, a legacy of having been a victim of these weapons during the war with Iraq (1980-1988) and its sole reliable conventional deterrent; and the network of partners and proxies it has built in the region in part to protect against external threats.91

B. Tehran: Maximum Patience

There is broad consensus in Tehran that waiting out the Trump administration is the best option available to Iran.92 At least until now, Iran has seen greater benefit in respecting the nuclear deal, taking advantage of growing U.S.-European tensions, heightened U.S. isolation and EU efforts to mitigate the effect of U.S. sanctions, than in itself violating the accord and reconstituting a united international front against it. As an IRGC strategist put it, “Iran will stay in the JCPOA as long as we can use it to delegitimise U.S. actions”.93 Iran also appears to have sought to avoid provoking the U.S. – or, as a senior Iranian official put it, “be provoked”94 – by engaging in more aggressive behaviour in the region, lest it encourage international buy-in to the U.S. pressure campaign or military retaliation.95 U.S. isolation, confirmation of Iran’s moral high ground by the International Court of Justice, and European efforts have

89 A French official said that his response, when pressed by his U.S. counterparts to join in efforts to punish Tehran, is to remind them that Washington was threatening French and other European firms. “Yes, we agree with the U.S. on a lot of issues about Iran. But they can’t expect us to simply ignore what they are doing to us and proceed as if that didn’t happen”. Crisis Group interview, Paris, December 2018. A German official said: “The Americans are basically telling our firms in our jurisdiction to ignore our laws and obey theirs. They have no respect for our sovereignty and this is totally unacceptable”. Crisis Group interview, Berlin, December 2018. “US pressuring German firms ‘daily’ over Iran sanctions”, Agence France Presse, 20 September 2018.


91 Tehran dubs this its “forward-defence” policy: an effort to exploit weak states, such as Lebanon and post-2003 Iraq, where it can meet its enemies on the battlefield through proxies without direct harm to Iran and its people. For more background on Iran’s regional priorities and decision making, see Crisis Group Middle East Report N°184, Iran’s Priorities in a Turbulent Middle East, 13 April 2018.

92 Crisis Group interviews, Iranian officials, Tehran, Brussels and Geneva, January-December 2018. This consensus endures despite repeated threats by Tehran to also withdraw. “Iran’s Khamenei threatens to ‘set fire’ to nuclear deal if West violates”, Reuters, 14 June 2016.


94 Crisis Group interview, New York, October 2018.

95 It has largely refrained from responding militarily to more than 200 Israeli strikes on its assets in Syria and engaging in skirmishes with the U.S. Navy in the Strait of Hormuz. “Israel says struck Iranian targets in Syria 200 times in last two years”, Reuters, 4 September 2018; “Iranian boats mysteriously stop harassing U.S. Navy”, Daily Beast, 8 October 2018.
allowed the Rouhani administration to continue on its current path, hoping that Trump will lose in 2020 and that the next U.S. president will rejoin the JCPOA.96

In practice, however, U.S. sanctions have turned out to be economically devastating, threatening the sustainability of Iran’s strategic patience policy and increasing pressure in Tehran to respond.97 In December, Iran’s former nuclear negotiator, Saeed Jalili, accused the Rouhani administration of weakness and “wasting the country’s time for seven months only to see whether they [Europeans] will ratify [the SPV] or not”.98 In January 2019, the country’s national security adviser warned that the time for Europe to salvage the deal had ran out.99 Even members of the Rouhani government are now questioning their own response to the U.S. withdrawal as overly timid.100

Iranians regularly convey these frustrations to their European interlocutors, warning of the consequences of the deal’s demise.101 They periodically have floated the notion of a less-for-less arrangement, pursuant to which Iran would roll back some of the JCPOA’s restraints and monitoring measures as a means of reciprocating the reimposition of U.S. sanctions. But Europe has firmly rejected any tinkering with the deal’s limits, pointing out that “though we oppose the U.S. withdrawal from the accord, it is for us essentially a non-proliferation agreement – which means that any Iranian violation of its nuclear components would immediately trigger European sanctions”.102

Whether the calculus in Tehran will change, and under what conditions, is unclear. Some officials assert that Iran will reach the breaking point if and when its oil exports fall below 700,000 barrels per day, which – they fear – could trigger hyper-inflation and nationwide protests.103 Domestic politics and jockeying ahead of Iran’s forthcoming elections and a possible struggle to succeed Supreme Leader Khamenei also


96 Crisis Group interviews, senior Iranian officials, New York, October 2018.

97 “Hard-liners attack Rouhani over outreach to Europe on JCPOA”, Al-Monitor, 18 December 2018.


99 As a senior Iranian diplomat put it, “the problem is that neither the U.S. nor Europe is paying any price, while tens of thousands of Iranians lose their jobs and millions struggle to make ends meet. If we had retaliated against the slow pace of sanctions relief with over-production of enriched uranium or similar measures, the Europeans would have been more proactive in trying to help our economy at this time of need. They underestimate the abrasiveness of Iran’s domestic politics at their own peril”. Crisis Group interview, Paris, November 2018.

100 “Iran’s president threatens to close Strait of Hormuz if U.S. blocks oil exports”, Radio Farda, 4 December 2018; “Iran’s Rouhani says sanctions may lead to drugs, refugee, bomb ‘deluge’”, Reuters, 8 December 2018.

101 Crisis Group interview, senior French official, Paris, October 2018. A senior Iranian diplomat complained, “the Europeans are hesitant when it comes to declaring the U.S. in breach of the JCPOA, but are resolute in considering the slightest violations on our part as cause for siding with the U.S. against Iran. Isn’t this the definition of a double standard?” Crisis Group interview, Berlin, November 2018.

could play a part, increasing hardline criticism of the Rouhani administration. Rouhani’s weakening could allow the hardliners, who have lost every election in Iran since 2012, to retake the parliament in 2020 and the presidency in 2021, putting them in better position to determine who and what comes after Khamenei. For his part, having watched his economic achievements and popular support vanish, Rouhani is likely to further align himself with the supreme leader, ensuring that even if his presidency seems doomed, he can survive politically beyond it as a potential heir to Khamenei’s mantle.

Should Iran decide that it must respond, its reprisal could take several forms. Tehran could creep past some of the JCPOA’s boundaries both as a show of defiance and in hopes of pressuring the deal’s remaining parties to do more to save it. On the lower end of the spectrum, Iran could overproduce a few kilograms of heavy water beyond the 130-tonne limit imposed by the deal. Such an infringement would fall in what an EU official called a “grey zone”: an action inconsistent with the accord, but which other co-signatories might not view as a justification for entirely scrapping the deal. Riskier would be a decision to accumulate more than 300kg of low-enriched uranium, enrich at a level higher than 3.67 per cent, testing a higher number of advanced centrifuges than allowed or interfere with IAEA monitoring. A senior Iranian official claimed that some in Tehran were advocating going so far as to withdraw from the non-proliferation treaty, thereby ending all IAEA inspections and limits on Iran’s nuclear program.

Alternatively, Iran could choose to respond asymmetrically by raising pressure on the U.S. presence in the region. This option arguably could be more attractive to Tehran, given that it could hide its hand by using proxies or allies, thereby reducing the risk of a European reaction, and given its relatively strong hand in the region.

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104 A gradual hardline takeover of elected institutions, taking advantage of widespread political apathy following failed attempts to institute socio-political reforms, would constitute a redux of 2004-2005 developments, which led to Mahmoud Ahmadinejad’s election to the presidency, after Iran’s nuclear deal with the E3 failed as a result of U.S. opposition. See Crisis Group Middle East Briefing N°18, Iran: What Does Ahmadinejad’s Victory Mean?, 4 August 2005.

105 One of Rouhani’s close advisers said: “If Rouhani was to run for re-election now, I think he would not secure more than three out of the 23 million votes he won in 2017. But that doesn’t mean his ambitions are limited to the second highest office in the land”. Crisis Group interview, New York, September 2018. Hesamodin Ashena, a close adviser to Rouhani, said, “Rouhani has come to the conclusion that survival takes precedence over progress, as does stability over reform”. “Ashena: Rouhani is a slow-paced politician”, ISNA, 12 December 2018.

106 Paragraph 14, Annex I, “estimates” Iran’s heavy-water needs to be 130 metric tonnes and requires all excess material to “be made available for export to the international market … and delivered to the international buyer for 15 years”.

107 Crisis Group interview, Brussels, 19 December 2018. A prominent Iranian academic (and a JCPOA proponent) has proposed a phased and reversible resuscitation of Iran’s nuclear program as a means of forcing the Europeans’ hand in delivering on their promises. Nasser Hadian, “I suggest a gradual JCPOA exit”, Etemaad, 1 December 2018.


109 Crisis Group interviews, Iranian diplomats and national security officials, Tehran, October-November 2018. As an IRGC official put it, “we just need to cross our borders to the east or the west to find U.S. forces as sitting ducks”. Crisis Group interview, Tehran, November 2018.
Speaking in October, a senior Iranian national security official surmised that the likeliest theatre for such a confrontation might well be Iraq:

We can add more fuel to the fires in Yemen, but that would not directly affect the U.S. There are U.S. forces in Afghanistan, but we lack the kind of assets there that we possess in the Levant. We have the upper hand in Lebanon and Syria, but the situation in both countries is quite fragile and our gains could be quickly reversed by adversaries and even friends. Iraq is where we have experience, plausible deniability and the requisite capability to hit the U.S. below the threshold that would prompt a direct retaliation.\(^{110}\)

The above scenarios – individually or in combination – are worrying, especially given the risk of miscalculation in the absence of any reliable channels of communication between the U.S. and Iran.

The alternative approach – renewing negotiations with the U.S. – seems unlikely even though it has been debated in Tehran. According to Iranian officials, decision makers considered three options: seriously negotiate with the Trump administration; engage in talks as a means of gaining time; or reject negotiations until the U.S. comes back into compliance with the JCPOA.\(^{111}\)

They seem to have quickly ruled out both genuine and tactical negotiations, concluding that risks outweighed potential benefits. Any indication of a willingness to talk, they feared, could validate Trump’s approach, demonstrating that pressure works, and thus inviting more.\(^{112}\) For Iran to negotiate after it scaled back or froze its nuclear program – and at a time when U.S. sanctions were biting – would have the added disadvantage of allowing the U.S. to deal from a position of relative strength.\(^{113}\)

Moreover, Washington’s harsh rhetoric toward the Iranian leadership has, in the words of a senior Iranian diplomat, rendered the Trump administration “radioactive” in Tehran and therefore “engagement with it a liability, not an asset, for any Iranian politician”.\(^{114}\)

The precedent of North Korea’s engagement with the Trump administration might plausibly have convinced Tehran to give talks a try. After all, talks between Trump and North Korean leader Kim Jong-un have lessened pressure on Pyongyang without forcing it to markedly curb its nuclear program.\(^{115}\) A senior Iranian official mused that talks between Presidents Trump and Rouhani could result in a vague statement including commitments already made by Iran under the JCPOA (eg, a

\(^{110}\) Crisis Group interview, Tehran, October 2018.

\(^{111}\) Crisis Group interviews, Geneva and Tehran, August-December 2018.

\(^{112}\) Crisis Group interviews, Geneva and Tehran, August-December 2018.

\(^{113}\) As Ayatollah Khamenei put it: “The Islamic Republic can negotiate with the U.S. only when it reaches a favourable level of power and sovereignty that would nullify the U.S.’s pressures and domining efforts”. Quoted in “Iran won’t negotiate with the U.S. for five reasons”, Khamenei.ir, 13 August 2018.

\(^{114}\) Crisis Group interview, Tehran, June 2018. For his part, the supreme leader could not be any clearer in expressing disdain for the Trump administration: “If the Islamic Republic’s government were to negotiate with the American regime, at any time, it would never negotiate with the present U.S. administration”. Khamenei.ir, 13 August 2018.

commitment never to seek a nuclear weapon), reduction of economic pressure on Iran, and a declaration of a historic breakthrough by the U.S. president. Nevertheless, even he had concluded that engaging in talks would be politically perilous and offer overly uncertain returns.

Unlike the North Korean case, moreover, both regional and domestic U.S. forces seem eager for a confrontational relationship with Iran, reducing the likelihood that a summit alone would fundamentally change dynamics. Too, Trump’s unpredictable and mercurial behaviour, the hardline views adopted by his senior advisers (both Bolton and Pompeo) and his administration’s pursuit of maximalist demands in talks with Pyongyang (at least according to briefings Iranians claim to have received from their North Korean counterparts) further discouraged Iranian advocates of negotiations. Arguably bolstering the case for a wait-and-see approach, some Iranian hardliners interpret U.S. actions in recent weeks (from outreach to Iran to discuss Afghanistan’s future to announcement of a withdrawal from Syria) as signs of growing acceptance of Iran and abating risks of confrontation.

For the time being, the leadership in Tehran seemingly believes that it can remain afloat economically at least until 2021, and does not seem particularly concerned about internal stability. It rests relatively easy despite a steady stream of demonstrations and strikes by almost all strata of Iranian society, from truckers to teachers, university students, women, dervishes, steel workers in Ahvaz and sugar mill workers in Haft Tappeh. The political elite is taking solace in the fact that although the number of protests is higher than previous years, their scale and scope have not been increasing and that there is no obvious link among protesters in various cities.

Whether the political establishment has taken the correct measure of its domestic challenge is uncertain. But it appears to believe that it understands the scope of popular discontent; that it has the will and capability to manage and – if necessary –

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117 Ibid.
118 Crisis Group interviews, Iranian officials, Geneva, August 2018. Foreign Minister Zarif assessed that any talks would be hopeless, citing his history with Bolton: “In 2005, John Bolton and I were both our countries’ respective ambassadors to the UN. With a few other countries we negotiated over thirteen paragraphs on disarmament for a UN General Assembly statement. We agreed on not even one paragraph”. Crisis Group interview, New York, 3 October 2018.
119 Crisis Group interviews, Tehran, January 2019. A prominent IRGC strategist said, “the reason the U.S. is willing to accommodate Iran is that its influence in the region is waning: in Syria, in Yemen, in Afghanistan, and elsewhere. If the U.S. had wanted to start a war against Iran, it wouldn’t have spread its assets all throughout the region and beyond. That’s a defensive posture, not an offensive one. As for an accidental war, all the parties to this conflict are aware of this and are careful to avoid it. The far greater risk derives from places in chaos, because this introduces an element of uncertainty”. Crisis Group interview, Tehran, 12 January 2019.
120 As a European diplomat in Tehran said, “if the leadership perceived an existential threat, it would not spend so much time fighting over petty issues. You would see them closing ranks”. Crisis Group interview, Washington, October 2018.
121 “Khomeini’s grandson and Rafsanjani’s daughter expect Iranian regime to collapse”, Middle East Monitor, 30 December 2018.
123 The government has commissioned multiple surveys and studies that clearly demonstrate that the society writ large is disillusioned with the revolution’s ideals, broadly disenchanted with all
suppress dissent;\textsuperscript{124} that it has done the necessary to shield its core constituents – ie, the lower-income, more pious strata – from the effects of U.S. sanctions;\textsuperscript{125} and that it has placated other elements sufficiently to prevent their grievances from snowballing into a nationwide crisis.\textsuperscript{126}

In an attempt to further undermine the protesters, the leadership has warned against a possible “Syria-cisation (سورية مازى) of the country – its violent fragmentation along ethnic and sectarian fault lines, purportedly as a result of efforts undertaken by the U.S. and its allies.\textsuperscript{127} Iran’s projected image of self-confidence is somewhat belied by the government’s aggressive reaction to what it views as attempts to destabilise it. It has thus responded brazenly to attacks claimed by ethnic minorities

\begin{itemize}
  \item political factions, and fed up with economic malaise. According to one such survey, 75 per cent of the population are dissatisfied with the country’s situation and 31 per cent have given up on reforming the system.
  \item trained and equipped anti-riot police, known as Special Units (پیکان و ژی), now taking the lead in stemming protest movements while avoiding violence to the extent possible.
  \item Twenty-two protesters were killed during the unrest that rocked nearly 100 cities in December 2017-January 2018. Saeid Golkar, “The evolution of Iran’s police forces and social control in the Islamic Republic”, Middle East Brief, Brandeis University, July 2018. With nearly 5,000 arrested during the protests, imprisonment seems the option of choice in dealing with demonstrations. Human rights groups have reported deaths of protesters either in street confrontations or in custody, an intensified crackdown on human rights lawyers and heavy sentences against protesters. “Local authorities in Iran say they will investigate shooting death of protester in Karaj”, Center for Human Rights in Iran, 9 August 2018; “Iran: Intensified Crackdown on Rights Defenders”, Human Rights Watch, 5 September 2018; “Protesters Sentenced in Unfair Trials”, Human Rights Watch, 5 November 2018.
  \item 75 per cent of the population are dissatisfied and 31 per cent believe the system is not reformable].
  \item “Supporting the five lower-income deciles”], IRIB, 1 September 2018; “14 percent increase in beneficiaries’ stipends”, Tasnim News, 18 July 2018.
  \item These have ranged from reimbursing depositors who had lost their assets after several unlicensed credit unions went bankrupt to deploying the IRGC to build a new potable water pipeline to Iran’s south-west regions, which experience drinking water shortages during the hot summer months. Thomas Erdbrink, David Kirkpatrick and Nilo Tabrizy, “How corruption and cronyism in banking fuelled Iran’s protests”, The New York Times, 20 January 2018; “Iran resolves water issue after demos in southern cities”, Press TV, 7 July 2018.
  \item As an Iranian sociologist explained: “All ideologies in Iran, from Islamism to leftist schools of thought, have proven to be an abject failure. The only organising principle than remains is patriotism, which the system is trying to mobilise in the face of external threats”. Crisis Group interview, Tehran, August 2018.
\end{itemize}
and the Islamic State (ISIS) with missile strikes in Iraq and Syria, and, according to European officials, targeting dissidents on European soil, as further described below.128

C. Brussels: Maxed Out

Europe’s strategy boils down to buying more time: for cooler heads to prevail in Tehran and return to power in Washington. This approach, however, has turned out to be a more difficult undertaking than initially anticipated. Europe awoke to the reality that there is very little state institutions can do to challenge the U.S. dollar’s global pre-eminence or dictate commercial decisions in an open market.129 This realisation gave rise to debate over the need to restore Europe’s economic sovereignty, but this ambition – assuming it is pursued – is unlikely to bear fruit to Iran’s benefit in the foreseeable future.130 As a French diplomat put it, “we have been clear with the Iranians that we cannot compensate them for the impact of the U.S. exit, but we will do what we can to help them save face by preserving as much as possible of our economic trade”.131 For their part, Iranians have a difficult time adjusting to this reality. An Iranian diplomat said, “Europe has the political but not the practical will to stand up to the U.S.”.132

128 Iran witnessed four violent attacks in urban centres in the past two years: on 7 June 2017, an attack claimed by ISIS killed seventeen and injured forty in Tehran; on 20 July 2018, the Kurdish militant group PJAK killed eleven and injured eight in Marivan; on 22 September 2018, an Arab separatist group and ISIS claimed responsibility for an attack on a military parade that killed 24 and injured 60 in Ahvaz; and on 6 December 2018, Ansar al-Furqan, a Baluchi militant group, claimed responsibility for killing two and injured 40 in Chabahar. In September 2018, the IRGC retaliated against the July attacks carried out by the Kurdistan Democratic Party of Iran (KDPI) by firing a dozen missiles at the groups’ bases in Iraqi Kurdistan, killing eleven and wounding 30. “Iranian Guards claims missile attack on Kurdish rebels in Iraq”, Al Jazeera, 9 September 2018. Tehran’s retaliation in October against alleged ringleaders of the attack on a military parade in Ahvaz on 22 September, which was claimed by both ISIS and a local Arab separatist group, took the form of missile strikes against ISIS in eastern Syria. “Iran fires missiles at militants in Syria over Ahvaz attack”, BBC, 1 October 2018. Iran appears to have been involved in plots targeting a Paris rally by the National Council of Resistance in June 2018 and the leader of the Arab Struggle Movement for the Liberation of Ahvaz in Denmark in September. In December, Albania expelled two Iranian diplomats for “activities in violation of their diplomatic status”. Matthew Dalton, “Bags of cash and a bomb plot: inside a covert Iranian operation in Europe”, Wall Street Journal, 31 October 2018; Martin Selsoe Sorensen, “Iran accused of plot to assassinate dissident in Denmark”, The New York Times, 1 November 2018; “Albania expels Iran envoy in ‘terrorist’ row”, BBC, 20 December 2018.

129 European officials complain that they learned of the decisions of some of their major companies to withdraw from the Iranian market through the media. Crisis Group interview, Paris, Berlin and Rome, September–December 2018.

130 “Germany calls for global payments system free of US”, Financial Times, 21 August 2018; “France vows to lead Europe in defying US on Iran sanctions”, Financial Times, 6 November 2018; “Brussels sets out plans for euro to challenge dollar dominance”, Financial Times, 3 December 2018.

131 Crisis Group interview, Paris, August 2018.

In reality, the measures taken by Europe, while symbolically significant, have yet to deliver practical dividends for Iran. In August, the EU updated its 1996 “blocking statute” that prohibits European companies from complying with secondary U.S. sanctions imposed on Iran.\textsuperscript{133} Unless they are specifically authorised to do so, firms that choose to comply with U.S. sanctions could now be subject to fines by European member states.\textsuperscript{134} Yet, even though some companies have left Iran specifically citing U.S. sanctions, member states have taken no notable enforcement measures since August.\textsuperscript{135} Iranian officials perceive other steps, such as the European Commission’s earmarking €18 million of a €50 million package for projects “in support of sustainable economic and social development” in Iran, as too little, too late.\textsuperscript{136}

Brussels has also had a few policy setbacks. The European Investment Bank, which was authorised by the European parliament and commission to lend to European projects in Iran, chose not to do so, lest it jeopardise its ability to raise funds in U.S. markets.\textsuperscript{137} In the same vein, European governments’ efforts to spare the Belgium-based SWIFT financial messaging service came to naught, as the company gave in to U.S. demands to disconnect most Iranian banks (including the country’s central bank) from its network.\textsuperscript{138} Refusal of some European member states to host the Special Purpose Vehicle dealt another blow to the credibility of these efforts.\textsuperscript{139}

Much will depend on the SPV’s effectiveness as the lynchpin of Europe’s efforts to preserve the JCPOA. The mechanism will be registered in the coming weeks in

\begin{quote}
\textquotedblleft[List of 145 state-owned European firms capable of cooperating with Iran	extquotedblright], IRNA, 26 November 2018.
\end{quote}

\begin{quote}
\textsuperscript{133} “Updated Blocking Statute in Support of Iran Nuclear Deal”, European Commission, 7 August 2018. Some European officials believe the blocking regulations might have backfired by pushing the companies to pull the plug on their Iran business before it came into effect. Crisis Group interviews, Berlin, November 2018.
\end{quote}

\begin{quote}
\textsuperscript{134} The statute allows EU operators who could prove that non-compliance with U.S. sanctions would seriously damage their interests or the interests of the Union to be exempt on a case-by-case basis. The EU has granted a few authorisations since August. Crisis Group interviews, Brussels, December 2018.
\end{quote}

\begin{quote}
\textsuperscript{135} EU officials expect more litigation cases to come to the fore as subcontractors who incurred damages as a consequence of major companies’ withdrawal from Iran take their cases to the courts. Crisis Group interview, Brussels, December 2018.
\end{quote}

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\textsuperscript{137} “Under U.S. pressure, EIB balks at EU plan to work in Iran”, Reuters, 5 June 2018. Among the EIB’s concerns were the possible risks to its triple-A credit rating. Crisis Group interview, European official, Washington, 18 July 2018.
\end{quote}

\begin{quote}
\textsuperscript{138} SWIFT called the decision “regrettable” and “taken in the interest of the stability and integrity of the wider global financial system”. See “SWIFT system to disconnect some Iranian banks this weekend”, Reuters, 9 November 2018.
\end{quote}

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\textsuperscript{139} Austria and Luxemburg were considered because of their prior experience with similar mechanisms and the pre-existence of the legal framework, which could expedite the SPV’s registration process. Crisis Group interviews, German, French and EU officials, Paris and Berlin, November 2018. “EU plan unravelling for non-dollar Iran trade, oil sales: diplomats”, Reuters, 14 November 2018. The delay in launching it stems from the complexity of the undertaking, which requires involvement of not just E3 diplomats, but their finance ministries as well as the judiciary.
\end{quote}
France, led by a German official, and have the E3 as its shareholders. While the channel, which offers a sophisticated compensation service for exports from and imports to Iran, is not primarily designed to be a humanitarian one, European officials expect that it will initially be used primarily for food and medicine until more trust is built in its sustainability. A key question is how the U.S. will react. As a senior EU official put it:

The SPV is not a magic wand. It is designed to give confidence to the market and without creating darkness at the heart of the global financial system. It is a fully transparent mechanism, where due-diligence knowledge could be shared. As a corollary, the U.S. could target it.

While the E3’s central banks’ ownership likely renders targeting the channel politically prohibitive for U.S. regulators, the SPV’s transparent nature renders its users vulnerable to U.S. penalties. Moreover, European companies may err on the side of over-compliance with U.S. sanctions, avoiding business with Iran altogether.

Given these challenges, it is easy to overlook the Europeans’ remarkable achievement in maintaining a united front in support of the JCPOA notwithstanding U.S. pressure (especially on eastern European states) and Europe’s conviction that Iran plotted to kill dissidents on European soil. The latter point was particularly costly and, as a senior European official put it, “plotting assassinations on European soil is the most damaging thing Iran could do after violating the JCPOA and sinking a U.S. warship”.

In so doing, Tehran was playing with fire, risking a significant backlash – including against the JCPOA – by the Europeans. Tehran has publicly referred to these attacks as false-flag operations aimed at driving a wedge between Iran and Europe – and privately as either that, an entrapment operation, or the work of rogue agents – but European officials say they possess strong evidence of Iran’s security apparatus’s involvement in the plots. On 8 January, the EU approved targeted sanctions

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141 Crisis Group interviews, EU officials, Brussels, 18–19 December 2018.
142 Dismissing the SPV, a U.S. official said: “A special-purpose vehicle is like the reverse Field of Dreams; if you build it, they will not come”. Quoted in “Briefing on Iran”, State Department, 3 December 2018. Pompeo said “should it be the case that the Europeans develop an SPV, we’ll look at it. There are humanitarian exemptions in the sanctions that have been put in place for foodstuffs and medicine. If the activity that is undertaken is consistent with that, we obviously won’t emplace sanctions. But to the extent that there are violations of our sanctions, we intend to enforce them with great rigor against any party who is a participant in those violations”. “Press Availability at the United Nations”, U.S. State Department, 12 December 2018.
143 Crisis Group interview, Brussels, 18 December 2018.
144 Crisis Group interview, Berlin, 27 November 2018.
145 Crisis Group interviews, Paris, Berlin and Washington, November–December 2018. A senior Iranian official who appeared quite uncomfortable offered a set of speculations, none of which was particularly convincing: “These were either false-flag operations, entrapments or rogue operations”. Crisis Group interview, September 2018. The Dutch government accused Iran of carrying out two such killings in the Netherlands, one in 2015 and the other in 2017; in June 2018, it expelled two Iranian diplomats as a sign it regards the operations as “unacceptable”. Adam Taylor, “Did Iran plot four attacks in Europe? The Dutch government thinks so”, Washington Post, 8 January 2019.
against two Iranian officials and a unit at Iran’s intelligence ministry.\textsuperscript{146} Iran protested the targeted sanctions, but so far they have not affected either party’s decision to maintain economic and diplomatic ties in an effort to preserve the nuclear deal.\textsuperscript{147}

\textsuperscript{146} Laurence Norman, “EU agrees fresh sanctions on Iran over assassination plots”, \textit{Wall Street Journal}, 8 January 2019.

\textsuperscript{147} “Tehran vows to retaliate after EU sanctions two Iranians”, Reuters, 9 January 2019.
IV. Die Another Day

While the U.S. exit from the JCPOA has not delivered the deal a fatal blow, 2019 could prove even more challenging than the past two years. Politics in Iran and the U.S. are likely to get more contentious as both countries near momentous elections. As sanctions take their toll on the Iranian people, and especially if mitigation efforts by remaining JCPOA signatories prove unsatisfactory, hardline voices in the Iranian leadership that favour leaving the agreement or making the U.S. pay for its actions will grow louder. Their renewed aggressiveness, coupled with electoral calculations, could call into question Iran’s policy of strategic patience.

In Washington, Trump’s unpredictability aside, two developments in 2020 could add more pressure on time in mutually reinforcing ways. One is the U.S. presidential election, which could be both a moment to showcase the results of Trump’s Iran policy and a time to sharpen differences between the administration and Democratic opponents. The second is the scheduled removal of the UN Security Council-imposed conventional arms embargo on Iran that, based on the JCPOA’s timetable, should be lifted in October 2020. In particular against the backdrop of national elections, the prospect of an embargo lift will likely amplify hawkish voices looking to increase pressure on Iran and against the JCPOA.

Finally, regional tensions—which have pitted Iran in a simultaneous three-front cold war against the U.S., Israel and Saudi Arabia—inevitably heighten the risk of an inadvertent or deliberate confrontation especially if, as noted above, some U.S. officials see benefit in a military clash. As detailed in Crisis Group’s Iran-U.S. Trigger List, an incident at any one of the points of friction among the parties, be it in Yemen, Syria, Iraq, Lebanon or the Gulf, or related to Iran’s missile tests, could escalate, with unpredictable consequences.

Avoiding these scenarios should be the priority for the coming year and will require several steps. To begin, Iran should not test the JCPOA’s boundaries or escalate regional tensions, either of which actions could persuade Europe to join the U.S. in its pressure campaign and aggravate the potential for a military confrontation. By demonstrating its willingness to play a more constructive role in the region, it could instead reduce the odds of both.

Arguably the most likely place to start is Yemen, where UN-sponsored talks offer a genuine hope for de-escalation and potential resolution of the four-year long conflict. As detailed in Crisis Group’s reports, just as the U.S and Western countries need to exert pressure on Saudi Arabia and the United Arab Emirates, so too does Iran need to press the Huthis to fully implement the initial deal brokered by the UN special envoy, Martin Griffiths, and engage in peace negotiations in good faith. Iran’s regional discussions with the E4 (the E3 plus Italy) should be deepened and

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149 These flashpoints can be monitored on Crisis Group’s “Iran-U.S. Trigger List”.
150 Crisis Group Middle East Report N°193, How to Halt Yemen’s Slide into Famine, 21 November 2018.
broadened to other security issues of common interest beyond Yemen.\textsuperscript{151} Relatedly, just as belligerent Iranian behaviour on the regional scene could alienate Europe, so too would a violent crackdown on protesters or human rights activists – let alone fresh attempts to kill dissidents on European soil.

If Iran wishes to maximise benefits from the SPV and other banking mechanisms, it should approve and implement outstanding legislation, including two bills on Iran’s accession to international conventions on terrorism financing and transnational organised crime, to fully address the due diligence, transparency, regulatory and other concerns laid out in its FATF action plan. Failure to do so could render the reputational cost of working with the Iranian banking sector prohibitive for international banks, and may lead to the reimposition of suspended FATF counter-measures that would further isolate Iran’s financial sector.

As far as Europe is concerned, it should focus on protecting and maintaining the JCPOA. To that end, the E3 ought to make every effort to ensure that the SPV succeeds, most importantly by providing clear briefings to European firms interested in using it for legitimate trade with Iran. Russia and China should join the SPV, turning it into a stronger multinational mechanism.

Going beyond economic incentives, European states should continue to regularly engage politically with Iranian officials at a high level. This engagement could include, at an appropriate time, a symbolically important visit by the E3’s foreign ministers to Tehran or a meeting of the JCPOA’s Joint Commission (the six remaining participants, coordinated by the EU) at the ministerial level to reaffirm Europe’s commitment to the JCPOA.\textsuperscript{152} Despite resistance by hardliners in Tehran, the EU should also pursue opening of an EU delegation office in Tehran, which could allow the EU to conduct more effective public diplomacy campaign in Iran.\textsuperscript{153}

Recognising Iran’s legitimate security concerns, Europe should take the lead in facilitating a regional security dialogue to lay the groundwork for an architecture tolerable to all sides, in which the region’s military imbalance could be addressed.\textsuperscript{154} Engagement does not mean that Europe should be indifferent to Iranian policies with which it has concerns, including human rights violations, plots against Iranian dissidents on European soil, or ballistic missile tests and transfers; rather, it means ensuring that its response to these activities does not undermine or overshadow its efforts to preserve the JCPOA. Any fresh sanctions should be targeted and carried out independently of steps taken to preserve the deal.

The U.S. side is more complicated, as there is little hope that the Trump administration will fundamentally alter its approach. Still, some steps could be useful. The newly seated House of Representatives will have a much greater appetite for over-

\textsuperscript{151} In 2018, Iran and the E4 held four rounds of talks, primarily about the conflict in Yemen, but also about Syria.
\textsuperscript{152} The last time the three foreign ministers were in Tehran was in October 2003. See Crisis Group Middle East Report N°18, Dealing with Iran’s Nuclear Program, 27 October 2003. Some initial discussions about such visits have taken place between Iranian and European senior officials. Crisis Group interviews, Berlin and Paris, December 2018.
\textsuperscript{154} Both Israel and Saudi Arabia outspend Iran on the military; and both have longer-range ballistic missiles and more advanced missile defence systems than Iran does. The former also possesses nuclear weapons.
sight of U.S. foreign policy; relevant committees could hold hearings on the admin-
istration’s Iran policy to help shine light on where it is creating a risk of conflict and,
where necessary, generate political pressure on the White House to take a step back.
As the 2020 election season gets underway, Democratic candidates could affirm
their intent to rejoin the JCPOA as long as Iran abides by its own obligations. Doing
so would send a message to the Iranian leadership that sticking to their nuclear
commitments is indeed the wiser approach.155

With regard to the administration, though some senior officials might in fact wish
to see Iran violate the JCPOA or offer another justification for a more robust response,
the president himself appears to genuinely want to negotiate. As discussed above,
there are reasons to doubt that Iran will agree in the near term, but the best option
would be for the U.S. to propose discreet, confidential talks focused on – but not
limited to – the release of U.S. citizens imprisoned in Iran. Under present circum-
stances, Iran probably would view public negotiations as an unacceptable surrender
to U.S. bullying; as occurred under the Obama administration, quiet diplomacy
(combined with a lowering of the rhetorical volume) stands a better chance of suc-
cess at the outset.

Separately, if the Trump administration wants the Iranian people to believe that
it harbours no rancour toward them, it ought to avoid impeding humanitarian trade
with the country. Specifically, the U.S. should not blacklist Iranian banks or penalise
their European or Asian counterparts engaged in humanitarian trade. Optimally, it
would facilitate – by issuing licenses or letters of comfort — efforts by the E3 and
Switzerland to establish banking channels that allow the Iranian people access to
food, medicine and other necessities.

For now, Iran’s policy of wait-and-see is far preferable to one of nuclear brink-
manship or regional escalation, but it too has its limitations. It hinges on the hope
that Trump will have a one-term presidency and that the next Democratic president
will choose to rejoin the JCPOA. The first scenario is uncertain and, while living
under heavy sanctions for two more years is one thing, doing so for an additional
four would be quite another; the second – while possible – would not be without its
own set of challenges. Most of the new sanctions that the Trump administration is
imposing on Tehran (nearly 500 new designations in addition to 400 individuals
and entities on whom nuclear sanctions were re-imposed) are non-nuclear-related;
they are framed as responses to Iran’s missile program and regional policies. This
framing could make it difficult (and, potentially, politically costly) for the next presi-
dent to lift them absent major – and improbable – turnarounds in those areas.

Timing also presents a potential hurdle, in that JCPOA-imposed limits on Iran’s
uranium enrichment capacity are set to expire in 2024. Even many of the deal’s
stauncheist U.S. advocates see the importance of using the time in the run-up to the

155 Senator Elizabeth Warren, Democrat of Massachusetts, paved the way in December when she
stated that, “if Iran maintains itself in compliance then I believe the president should reverse his
reckless decision to withdraw from the nuclear deal and reimpose sanctions because the deal makes
America safer and makes the world safer”. See “Warren on the Iran agreement”, C-SPAN, 4 Decem-
ber 2018. Warren has made clear her intention of running for the presidency.
sunsets to try to negotiate a supplemental and more sustainable arrangement. If a candidate who favours rejoining the JCPOA wins the presidency, he or she might wish to negotiate a follow-on agreement with very little time left on the clock.

The fact is that none of the parties to the JCPOA is fully satisfied with the deal. Iran wishes that the sanctions relief was much more extensive. Both the U.S. and Europe dislike the rapidly approaching sunset clauses regarding certain nuclear activities and would prefer to add language addressing Tehran’s ballistic missile program or regional activities. While Iran understandably feels burned by the U.S.’s violation of the deal, and thus refuses to consider a successor agreement – at least so long as the U.S. remains in non-compliance – it would make sense for all parties to start considering what a better-for-better arrangement could look like, addressing some of the U.S.’s (and Europe’s) concerns about Iran’s regional and missile activities, in return for additional relief from both primary and secondary U.S. sanctions.

Those discussions in theory could start from scratch in January 2021, but it would be wiser to begin thinking about it in advance.


157 The next U.S. president will be inaugurated in January 2021. Rouhani will leave office in August of that year.
V. Conclusion

The paradox of the Trump administration’s Iran policy is that, whether sanctions fail or succeed, it has little chance of achieving its stated goals and runs a real risk of inducing the opposite outcome. If Iran perseveres in its strategic patience and opts to wait the Trump presidency out, the administration will have neither obtained the better deal to which it aspires nor altered Iran’s behaviour. At that point, those in the administration and among the U.S.’s regional allies could press for a more belligerent policy – a prospect to which Secretary Pompeo has alluded by arguing that “we are accumulating risk of escalation in the region if we fail to restore deterrence [against Iran]”. Conversely, if sanctions and pressure truly harm Iran, its leadership could become less risk-averse and take actions in the nuclear or regional realms inimical to U.S. interests.

Hopes that domestic turmoil will threaten the Iranian leadership appear equally questionable, at least in the short term. As discussed above, years of experience in managing an anaemic economy with high inflation and extensive practice in skirting U.S. sanctions, coupled with continued economic engagement with the EU, China, Russia, India and some of Iran’s neighbours, could help Tehran keep the economy afloat. Protests could well grow in scale and scope but for now there is little sign of them turning into a nationwide movement; if they do, the security apparatus can be expected to put its formidable repressive capability to work. And, if U.S.-Iranian tensions provoke a military confrontation, the leadership might be better able to rally popular support and thus boost its fortunes at a time when it is embattled.

The JCPOA’s demise is not inevitable. Its survival following the U.S. exit is largely the result of European efforts to preserve a modicum of trade with Iran – and of Tehran’s patience. For now, the priority should be to stay this course, even as an assessment of how to bolster the deal sometime in the future begins.

Tehran/Washington/Brussels, 16 January 2019

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158 Pompeo said: “As we have been warning for some time, Iran’s missile testing and missile proliferation is growing. We are accumulating risk of escalation in the region if we fail to restore deterrence. We condemn these activities, and call upon Iran to cease immediately all activities related to ballistic missiles designed to be capable of delivering nuclear weapons”. “Iran Test Launches Ballistic Missile Violating UN Security Council Ban”, State Department, 1 December 2018.

159 “Khamenei calls for vigilance against American plans next year”, Radio Farda, 12 December 2018.

160 An IRGC strategist said: “Trump is a gift from heaven. Exactly at the time that most thought Iran’s revolutionary spirit had atrophied, the U.S. re-energised our fever and alienated our middle class, creating a new generation of anti-American zealots”. Crisis Group interview, Tehran, October 2018.
Appendix A: Map of Iran
Appendix B: Iran’s Ballistic Missile Tests and Launches (2015-2018)

Compiled from UN and media reports
Appendix C: About the International Crisis Group

The International Crisis Group (Crisis Group) is an independent, non-profit, non-governmental organisation, with some 120 staff members on five continents, working through field-based analysis and high-level advocacy to prevent and resolve deadly conflict.

Crisis Group’s approach is grounded in field research. Teams of political analysts are located within or close by countries or regions at risk of outbreak, escalation or recurrence of violent conflict. Based on information and assessments from the field, it produces analytical reports containing practical recommendations targeted at key international, regional and national decision-takers. Crisis Group also publishes CrisisWatch, a monthly early-warning bulletin, providing a succinct regular update on the state of play in up to 70 situations of conflict or potential conflict around the world.

Crisis Group’s reports are distributed widely by email and made available simultaneously on its website, www.crisisgroup.org. Crisis Group works closely with governments and those who influence them, including the media, to highlight its crisis analyses and to generate support for its policy prescriptions.

The Crisis Group Board of Trustees – which includes prominent figures from the fields of politics, diplomacy, business and the media – is directly involved in helping to bring the reports and recommendations to the attention of senior policymakers around the world. Crisis Group is chaired by former UN Deputy Secretary-General and Administrator of the United Nations Development Programme (UNDP), Lord (Mark) Malloch-Brown.

Crisis Group’s President & CEO, Robert Malley, took up the post on 1 January 2018. Malley was formerly Crisis Group’s Middle East and North Africa Program Director and most recently was a Special Assistant to former U.S. President Barack Obama as well as Senior Adviser to the President for the Counter-ISIL Campaign, and White House Coordinator for the Middle East, North Africa and the Gulf region. Previously, he served as President Bill Clinton’s Special Assistant for Israeli-Palestinian Affairs.

Crisis Group’s international headquarters is in Brussels, and the organisation has offices in seven other locations: Bogotá, Dakar, Istanbul, Nairobi, London, New York, and Washington, DC. It has presences in the following locations: Abuja, Algiers, Bangkok, Beirut, Caracas, Gaza City, Guatemala City, Hong Kong, Jerusalem, Johannesburg, Juba, Mexico City, New Delhi, Rabat, Tbilisi, Toronto, Tripoli, Tunis, and Yangon.


January 2019
Appendix D: Reports and Briefings on the Middle East and North Africa since 2016

**Special Reports**

Exploiting Disorder: al-Qaeda and the Islamic State, Special Report N°1, 14 March 2016 (also available in Arabic and French).

Seizing the Moment: From Early Warning to Early Action, Special Report N°2, 22 June 2016.


**Israel/Palestine**

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